Hold ?

26 November 1985

MEMORANDUM FOR: Distribution

SUBJECT : Inter-Agency Meeting

Type of Meeting	Economic Policy Council
Date	27 November 1985
Time	0930
Place	Roosevelt Room
Chaired By	Baker
Attendees	NIO/Econ
Subject/Agenda	S.812
Papers Expected	N/A
Info Received	1800, 25Nov85, per Anne, Cabinet Affairs

Cancelled

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Cancelled per Anne 11/26

informed

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MEMORANDUM FOR: Mr. Casey

George Fulsom from the Office of the Secretary of the Defense (697-9347) called concerning yesterday's canceled NSC meeting on S-812 (Financial Export Control Act.) The issue will now be addressed at the EPC meeting

Date on Wednesday →

FORM 5-75 101 USE PREVIOUS EDITIONS

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MEMORANDUM FOR:

at 9:30 am. The President will not attend, but Mr. Weinberger probably will. Would appreciate Mr. Casey contact Mr. Fulsom if he will attend or not, and to advise coordination!

*passed message to DCI Security

Date 25 Nov-85

SDO/Chief 1845

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TRANSMITTAL SLIP [redacted] DATE 26 Nov 85

STAT

REMARKS:

TW

Tony

FYI + fw

EPC

[redacted]

STAT

FROM: Acting NIO/Econ

ROOM NO. 7E48 | BUILDING [redacted]

STAT

FORM NO. 241
1 FEB 56
REPLACES FORM 36-8 WHICH MAY BE USED.

WASHFAX RECEIPT

THE WHITE HOUSE

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P 8: 23

Nov 25 8 36 PM '85

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MESSAGE NO. 037 CLASSIFICATION UNCLAS PAGES 6

FROM Nick Klissas
(NAME) (EXTENSION) (ROOM NUMBER)

MESSAGE DESCRIPTION

TO (AGENCY)	DELIVER TO:	DEPT/ROOM NO.	EXTENSION
A		410/Economics	STAT STAT
D	Dr. Dov Zakheim	Undersec Def	70209

REMARKS Urgent Call for Pickup

THE WHITE HOUSE

WASHINGTON

November 25, 1985

MEMORANDUM FOR DOUGLAS W. McMINN
DAVID C. MULFORD
D. LOWELL JENSEN
S. BRUCE SMART
ALTON G. KEEL
MICHAEL B. SMITH
THOMAS G. MOORE

FROM: EUGENE J. McALLISTER EM

SUBJECT: Financial Export Control Legislation

The Economic Policy Council is scheduled to consider the issue of financial export control legislation on Wednesday, November 27. A draft memorandum outlining the background of the issue, the policy objectives, and options is attached. I would appreciate your providing any comments or suggestions on the memorandum to Lehmann Li (456-6402) by 12:00 p.m. on Tuesday, November 26.

I apologize for the quick turnaround, but this item was just scheduled. Thank you very much for your cooperation.

cc: Stephen I. Danzansky

Attachment

DRAFT

November 25, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

SUBJECT: Financial Export Control Legislation

Issue

Should the Administration support a new policy of restricting U.S. capital flows to the Soviet Bloc in non-emergency as well as emergency situations?

Background

In March 1985, Senators Garn and Proxmire introduced S. 812, the "Financial Export Control Act," which would amend the Export Administration Act to authorize the President to prohibit, curtail, monitor, or otherwise regulate the export of U.S. capital to the Soviet Bloc. Supporters of this legislation argue, inter alia, that U.S. bank lending is helping the Soviet Bloc import Western technology and finance activities that adversely affect U.S. national security.

The International Emergency Economic Powers Act (IEEPA) currently grants the President the authority to restrict U.S. capital flows to the Soviet Bloc only in the case of emergencies threatening the national security or economy of the U.S. S. 812 is primarily designed to provide the President with the discretionary authority to restrict such capital flows in non-emergency cases as well. In addition, S. 812 could provide the President with discretionary authority to restrict capital flows to nations that support international terrorism or threaten regional stability.

The Senate Banking Committee is scheduled on December 3 to hold a hearing on S. 812 and has invited the Administration to testify on the legislation.

Policy Objectives

The following major policy objectives should guide the Administration's consideration of this issue:

Strengthen national security. To what extent would restricting U.S. bank lending to the Soviet Bloc strengthen U.S. national security? The ability of the Soviet Bloc to generate hard currency through either exports or loans enhances their ability to import Western technology, which could harm U.S. national security and force the U.S. to devote more economic and budget resources to maintaining our technological lead. In addition, some argue that increased U.S. bank lending to the Soviet Bloc has helped it underwrite policies that hurt U.S. national security. For example, some U.S. loans to East Germany coincided roughly with the announcement of East German and other Soviet Bloc credit lines to Nicaragua.

Some argue that unilaterally restricting U.S. bank lending to the Soviet Bloc would reduce its ability to import Western technology. Others argue that without cooperation by non-U.S. lenders, unilaterally restricting U.S. bank lending to the Soviet Bloc would not affect its ability to import Western technology because other lenders would displace U.S. banks.

[State provide language on effect of legislation on U.S.-Soviet relations.]

Maintain strong relations with our allies. To what extent would attempting to restrict the flow of U.S. bank lending to the Soviet Bloc affect our relations with West European allies? Given the fungibility of capital and availability of non-U.S. capital sources, any restriction of the total flow of capital to the Soviet Bloc would require the cooperation of non-U.S. lenders. Yet, our COCOM allies and other cooperating countries would strongly resist U.S. efforts to impose further controls on capital flows to the Soviet Bloc. An effort in 1982 to persuade our major allies to agree to restrict official credits to the Soviet Bloc failed. [State check]

There are two generic risks to U.S. relations with our allies:

o Given the need to obtain the cooperation of all Western lenders in order to restrict effectively the total flow of capital to the Soviet Bloc, attempting to restrict such flows could strain relations with our allies, particularly West European countries that currently lend significant amounts to the Soviet Bloc.

o Attempting to restrict the flow of U.S. bank lending from not only domestic banking offices, but also overseas branches and subsidiaries of U.S. banks, raises the sensitive issue of extraterritoriality.

Enhance U.S. economic competitiveness. To what extent would attempting to restrict the flow of U.S. bank lending to the Soviet Bloc adversely affect U.S. economic interests? There are at least two major economic risks:

o Without cooperation by non-U.S. lenders to restrict total capital flows to the Soviet Bloc, restricting U.S. bank lending to the Soviet Bloc would simply reduce business opportunities for U.S. financial and commercial firms.

o Restricting the outflow of U.S. capital could eventually lead to less foreign capital inflow and thus higher U.S. interest rates because of the following. Foreign investors find the U.S. financial markets attractive in part because of the absence of any U.S. exchange controls. Foreign investors could infer from legislation restricting U.S. bank lending to

the Soviet Bloc a greater willingness by the U.S. to impose financial sanctions against residents of any country with which the U.S. differed. Such a perception could decrease the foreign demand for U.S. assets and raise U.S. interest rates.

Gain the support of U.S. banks for the LDC debt initiative. Restricting the flow of U.S. bank lending in non-emergency cases could jeopardize the Administration's efforts to obtain the cooperation of U.S. banks in the LDC debt initiative.

Policy Options

The Administration faces the issue of whether to support a new policy of restricting U.S. capital flows to the Soviet Bloc in non-emergency as well as emergency cases. Since the IEEPA grants the President the authority to restrict such flows only in emergency cases, a decision to support a new policy of restricting such flows in non-emergency cases would require the Administration to support new legislation, for example, S. 812 or some other bill, granting the President the authority in non-emergency cases as well. [Check Justice whether this could be done administratively.]

Option 1: Support a policy of restricting U.S. capital flows to the Soviet Bloc in non-emergency as well as emergency cases. Support legislation, for example, S. 812, that grants the President the authority to restrict such flows in non-emergency cases.

Advantages

o If such a policy succeeded in restricting the flow of total, not just U.S., capital to the Soviet Bloc, it could reduce the ability of the Soviet Bloc to import Western technology.

[The Departments of State, the Treasury, and Commerce argue that unless the U.S. sought the cooperation of non-U.S. lenders, such a policy would not reduce the ability of the Soviet Bloc to import Western technology because other lenders would displace U.S. banks.]

o The President should have the authority to restrict U.S. capital flows in non-emergency cases, for example, where other countries support international terrorism or threaten regional stability. The IEEPA does not grant the President authority to restrict U.S. bank lending in such cases. The Department of Justice suggests that relying on IEEPA to address non-emergency cases could make trivial this critical foreign policy tool and perhaps lead the Congress perversely to attempt to remove some Presidential authority under that law. [Justice check]

Option 2: Continue the current policy of not restricting arms-length non-concessional business, including U.S. bank lending to the Soviet Bloc.

Advantages

- o Attempting to restrict the flow of U.S. bank lending to the Soviet Bloc could strain relations with our allies, particularly West European countries that currently lend significant amounts to the Soviet Bloc.

- o Restricting the flow of U.S. bank lending *per se* to the Soviet Bloc would be ineffective because such lending would be displaced by lending from non-U.S. financial institutions. Even if the U.S. succeeded in restricting the total flow of Western bank lending to the Soviet Bloc, those countries could still import Western technology by reallocating foreign exchange from other uses, i.e., there would be some reduction of total imports, but not necessarily of technology.

- o Unrestricted U.S. bank lending would support the competitiveness of U.S. firms selling non-strategic products to the Soviet Bloc.

- o Maintaining the confidence of foreign investors that the U.S. financial markets will remain open maintains the attractiveness of investing in U.S. assets and thus avoids raising U.S. interest rates.

- o Restricting U.S. bank lending in non-emergency cases could jeopardize the Administration's efforts to obtain the cooperation of U.S. banks in the LDC debt initiative.